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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 92.

FLORENCE GUGGENHEIM,

Petitioner,

vs.

ALMON Q. RASQUIN, individually and as United States Collector of Internal Revenue for the First District of New York.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONER.

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Opinions Below.

The opinion of the United States District Court for the Eastern District of New York (R. 175-181) is reported in 28 F. Supp. 322. The opinion of the United States Circuit Court of Appeals for the Second Circuit (R. 194-198) is reported in 110 F. (2) 371.

Jurisdiction.

The judgment of the Circuit Court of Appeals reversing the District Court was entered on April 3, 1940 (R. 198). The petition for certiorari was filed May 21, 1940, and granted October 14, 1940 (R. 200). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

The sole question presented is the value for Federal gift tax purposes of nine single premium life insurance

policies—is it their cash surrender value, as contended by petitioner, or is it their cost, as contended by the respondent.

Statutes and Regulations Involved.

The applicable statutory provisions appear in the appendix, infra, pp.

Statement.

The pertinent facts alleged in the petitioner's complaint and admitted by the respondent's answer and the stipulation of facts are briefly as follows:

In December of 1934 the petitioner purchased nine single premium life insurance policies. In each of these policies the petitioner was named as the insured, all of the policies were payable to the petitioner's estate, and the petitioner reserved the right to change the beneficiary (R. 25, 27, 43, 45, 57, 59, 77, 81, 93, 95, 113, 115, 127, 133, 147, 151, 159, 161).

The policies and the dates of assignment[1] (R. 6, 17, 21) are as follows:

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[1] It is to be noted that the date of Policy No. 1,225,190 of the Union Central Life Insurance Company is December 31, 1934 and that the date of the assignment is December 27, 1934 (R. 23, 93). Policies numbered 1,226,200 and 1,226,201 of the Union Central Life Insurance Company are dated December 31, 1934 but were not issued until January 7, 1935. The date of the assignments in each case is December 31, 1934 (R. 25, 91, 157, 159). Policy No. 9,687,735 of The Equitable Life Assurance Society bears a register date of December 27, 1934 (R. 143) was executed by the company on January 8, 1935 (R. 127) and assigned by the petitioner on December 27, 1934 (R. 123). The petitioner and the respondent have stipulated that all of these policies were assigned on December 31, 1934 with the exception of the Equitable Life Assurance Society policy which was assigned on December 27, 1934 (R. 21).

It is to be further noted that page 25 of the record should be substituted for page 159; page 159 should be substituted for page 93; and page 93 should be substituted for page 25. These errors occurred in the printing of the instant record.

Insurance Company	Number of Policy	Face Amount	Date of Policy	Cost	Date Assigned	Cash Surrender Value When Assigned	Assignee
Union Central Ins. Co.	1,225,190	$130,000.	12/31/34	$109,920.20	12/31/34	$ 90,632.07	M. Robert Guggenheim
Connecticut General Ins. Co.	462,569	100,000.	12/27/34	77,784.00	12/27/34	65,283.02	M. Robert Guggenheim
New York Life Insurance Co.	12,486,936	100,000.	12/29/34	84,528.00	12/29/34	73,508.00	Gladys C. Strauss
National Insurance Co. of Vermont	632,645	100,000	12/27/34	86,550.00	12/27/34	74,150.94	Gladys C. Strauss
Union Central Insurance Co.	1,226,200	45,000.	12/31/34	38,049.30	12/31/34	31,372.64	Gladys C. Strauss
The Prudential Insurance Co. of America	8,740,620	100,000	12/27/34	84,886.00	12/27/34	71,980.68	Gladys C. Strauss
The Equitable Life Assurance Society of the United States	9,687,735	200,000.	12/27/34	170,778.00	12/27/34	146,446.72	Harry G. Guggenheim
The Mutual Life Insurance Company of New York ...	4,918,863	200,000.	12/27/34	169,208.00	12/27/34	146,541.50	Harry G. Guggenheim
Union Central Insurance Co.	1,226,201	25,000.	12/31/34	21,138.50	12/31/34	17,429.24	Harry G. Guggenheim
		$1,000,000.		$842,842.00		$717,344.81	

On March 15, 1935, the petitioner filed a Federal gift tax return for the calendar ~~year 1934~~, and at the same time paid a tax thereon in the amount of $52,872.93 (R. 5, 17). In this gift tax return the petitioner, on the basis of Article 2 (5) of Regulations 79 (1933 Ed.), reported, as taxable gifts, the nine single premium life insurance policies in question. The total value of these policies was returned as $717,344.81, which was the total of their admitted cash surrender value on the date they were irrevocably assigned (R. 6-7, 17, 21).

The Commissioner of Internal Revenue on August 3, 1936 determined that these policies should be valued not on the basis of their cash surrender values on the date they were irrevocably assigned to the named donees, but on the basis of their cost to the petitioner. The Commissioner's determination was based on Article 19 (9) of the 1936 Regulations. The total cost paid by the petitioner was $842,842. On the basis of this determination the Commissioner of Internal Revenue, on January 11, 1937, assessed a deficiency in gift tax against the petitioner in the amount of $13,804.69, plus interest thereon of $1,450.05, which was paid by the petitioner to the respondent on January 25, 1937 (R. 7, 17-18).

On June 30, 1938, the petitioner filed with the respondent a claim for refund of the aforesaid assessment of $13,804.69 and interest paid thereon in the amount of $1,450.05. The Commissioner of Internal Revenue on October 6, 1938 denied this claim for refund in its entirety, and the petitioner thereupon filed suit in the United States District Court for the Eastern District of New York on November 9, 1938. On June 1, 1939, the petitioner filed a motion for judgment on the pleadings under Rule 12 (c) of the New Rules of Civil Procedure for District Courts of the United States (R. 3, 7-8, 10-14, 17).

The District Court granted the petitioner's motion for judgment on the pleadings and held that Article 2 (5) of Regulations 79, promulgated on October 30, 1933, set forth the rule that the cash surrender value of a single premium life insurance policy was the true measure of its value for

gift tax purposes. Further, the District Court held that in view of the reenactment by Congress in 1934 of Section 506 of the Revenue Act of 1932, it must be presumed that Congress had knowledge of the foregoing regulation promulgated in 1933 by the Treasury Department and thereby approved it. *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488; *National Lead Co.* v. *U. S.*, 252 U. S. 140, 146.

In 1936 the Treasury Department promulgated a new regulation (Article 19 (9) of Regulations 79) which defined the value of a single premium life insurance policy to be the amount paid to the company. The District Court ruled that the 1936 Regulation could not be applied retroactively to the instant gifts and stated:

> "It is, of course, conceivable that a regulation promulgated by an executive branch of the Government may require correction, but where the Department has acted for years under an expressed interpretation and Congress implicitly has accepted such interpretation through re-enactment of the same statute, the new interpretation should not without a showing of Congressional authority have a retroactive effect. Helvering *v.* R. J. Reynolds Tobacco Co., 306 U. S. 110." (R. 178)

The District Court thereupon concluded that when the petitioner in 1934 acted within the provisions of the Treasury Regulations in effect at that time, she was acting within the law. "Application of the 1936 regulation would in effect attempt to destroy the legality of the plaintiff's act without warrant of law." (R. 179)

The Circuit Court reversed the District Court's determination and held that the value of a life insurance policy is the cost to duplicate the policy at the time of the gift.

With the exception of the Circuit Court below, the Circuit Court of Appeals for the First Circuit[2], and the

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NOTE:

[2] *Comm.* v. *Powers,* not officially reported, 1940 Prentice-Hall Federal Tax Service, par. 62785, cert. granted Nov. 12, 1940.

District Court for the Northern District of Illinois, whose decision was reversed by the Circuit Court of Appeals for the Seventh Circuit[3], every Court and every Board of Tax Appeals case[4] has uniformly held that the 1933 Regulations, Article 2 (5) laid down the rule that cash surrender value was the value prescribed for valuing a single premium life insurance policy, and that single premium life insurance policies should be so valued.

Specification of Errors Urged

The United States Circuit Court of Appeals for the Second Circuit erred:

1. In holding that the Treasury Regulations 79 (Article 2 (5)) in effect in 1934 did not prescribe that cash surrender value be taken as the value of a gift of a single premium life insurance policy.

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[3] *Ryerson* v. *U. S.*, 28 F. Supp. 265, reversed 114 F. (2) 150, cert. granted Nov. 12, 1940.

[3] *Comm.* v. *Haines,* 104 F. (2) 854 (C. C. A. 3); *Helvering* v. *Cronin,* 106 F. (2) 907 (C. C. A. 3); *Helvering* v. *Bryan,* 109 F. (2) 430 (C. C. A. 4); *U. S.* v. *Ryerson,* supra (C. C. A. 7) cert. granted Nov. 12, 1940; *Guggenheim* v. *Rasquin, supra,* (D. C. E. D. N. Y.).

[4] *Charles Lockhart,* Memo B. T. A. June 30, 1938, petition for review dismissed by C. C. A. 3 on Sept. 15, 1939; *Henry W. Corning,* Memo B. T. A. Dec. 8, 1938; *Elizabeth S. Kirk,* 39 B. T. A. 902, appealed to C. C. A. 3; *Flora D. Supplee,* Memo B. T. A. June 26, 1939, appealed to C. C. A. 3; *Louis Florsheim,* Memo B. T. A. Sept. 11, 1939, appealed to C. C. A. 7; *Edith W. Corning,* Memo B. T. A. Jan. 30, 1940, appealed to C. C. A. 6; *Bettie F. Kesner,* Memo B. T. A. Jan. 31, 1940, appealed to C. C. A. 7; *Samuel F. Houston,* Memo B. T. A. Mar. 5, 1940; *Firman V. Desloge,* Memo B. T. A. Mar. 18, 1940; *Estate of Waller C. Hardy,* Memo B. T. A. June 28, 1940. See also *Blaffer* v. *Comm.,* 103 F (2) 489 (C. C. A. 5), and *Farish* v. *Comm.,* 103 F. (2) 1011 (C. C. A. 5).

2. In holding that the value for gift tax purposes of a gift of a single premium life insurance policy is not the cash surrender value of the policy when it is irrevocably assigned.

3. In holding that the value for gift tax purposes of a gift of a single premium life insurance policy is to be measured by the cost of the insurance.

Summary of Argument

The petitioner's tax liability for the year 1934 must be determined in accordance with the approved regulations then in effect, provided such regulations are a reasonable and consistent interpretation of Section 506 of the Revenue Act of 1932.

Article 19 (1) of Regulations 79 (1933 Ed.) in dealing with the valuation of property in general provides that the value of property for gift tax purposes shall be its fair market value, that is, the price at which property will change hands between a willing buyer and a willing seller, neither being under the compulsion to buy or to sell.

Article 2 (5) of Regulations 79 (1933 Ed.) lays down the rule that the fair market value of a single premium life insurance policy shall be its cash surrender value on the date of the gift.

Articles 19 (1) and 2 (5) of Regulations 79 (1933 Ed.) prescribe a rule which is a reasonable and consistent interpretation of Section 506 of the Revenue Act of 1932.

Congress gave to these Articles the force and effect of law by re-enacting without change Section 506 in the Revenue Acts of 1934 and 1935. Accordingly, Article 19 (9) of the 1936 Regulations cannot be applied retroactively. *Helvering v. R. J. Reynolds Tobacco Co., supra.*

POINT I.

The petitioner's liability for 1934 gift tax is to be determined by the approved regulations then in effect.

Section 501 of the Revenue Act of 1932 imposes a gift tax upon all transfers of property to the extent that they are donative in character and exceed the authorized deductions. Section 506 of this Act provides:

> "If the gift is made in property, the value thereof at the date of the gift shall be the amount of the gift."

The word "value" is susceptible of many meanings. There is no fixed general rule of law which determines the valuation of property. The factors entering into the concept of value vary with types of property and with the purpose or use to be made of the valuation. Again, the relative weight to be attached to the different factors may vary. Accordingly, in view of the very general and indefinite standard fixed by Congress for the determination of the value of a gift of property, it became a practical necessity for the Commissioner of Internal Revenue to designate some test of value which could be used to fix the amount of the gift in terms of money.

On October 10, 1933, the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, promulgated an administrative regulation, Regulations 79, in pursuance of authority vested in him by Section 530 of the Revenue Act of 1932. Article 19 (1) of these regulations deals with the valuation of property in general and provides as follows:

> "Art. 19. *Valuation of property.*—(1) *General.*— The statute provides that if the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift. The value of property is the price at which such property would change hands between a willing buyer and a willing

seller, neither being under any compulsion to buy or to sell. Where the property is sold within a reasonable period after the date of the gift, and it is shown that the selling price reflects the fair market value thereof as of the date of the gift, the selling price will be accepted as the amount of the gift. All relevant facts and elements of value should be considered in every case."

Article 2 (5) of these regulations deals specifically with the valuation of life insurance policies, and provides as follows:

> "The irrevocable assignment of a life insurance policy, or the naming of the beneficiary of a policy, without retaining any of the legal incidents of ownership therein, constitutes a gift in the amount of the net cash surrender value, if any, plus the prepaid insurance adjusted to the date of the gift."

Subsequently, the General Counsel of the Treasury Department issued a memorandum based on Article 2 (5) wherein examples illustrating the Bureau's interpretation of the valuation of life insurance contracts were set forth. G. C. M. 13147; C. B. June 1934, page 358. There is no evidence, or any reported case to indicate that prior to 1936 the Commission did not apply Article 2 (5) to the valuation of all life insurance policies including single premium policies.

The Revenue Act of 1934 was enacted on May 10, 1934, and Congress re-enacted Section 506 of the Revenue Act of 1932 without making any change therein. In the Revenue Act of 1935, Section 506 of the Revenue Act of 1932 was again re-enacted without change. Furthermore, Article 2 (5) remained unchanged in the 1934 and 1935 editions of Treasury Regulations 79.

In *Helvering v. Winmill*, 305 U. S. 79, 83, the Supreme Court stated that:

> "Treasury regulations and interpretations long continued without substantial change, applying to

> unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law."

To the same effect—*McCaughn* v. *Hershey Chocolate Co.*; *National Lead Co.* v. *United States*, supra.

On February 26, 1936, the Treasury Department completely changed Article 2 (5) and provided therein *inter alia* "For the valuation of life insurance, see subdivision (9) of Article 19." Article 19 (9) of the 1936 edition of Regulations 79 provides:

> "(9) *Life insurance and annuity contracts.* The value of a life insurance contract or of a contract for the payment of an annuity issued by a company regularly engaged in the selling of contracts of that character is established through the sale of the particular contract by the company, or through the sale by the company of comparable contracts. * * *
>
> Example: A donor owning a life insurance policy on which no further payments are to be made to the company (e. g., a single premium policy or paid-up policy) makes a gift of the contract. The value of the gift is the amount which the company would charge for a single premium contract of the same specified amount on the life of a person of the age of the insured."

The Government, subsequent to the promulgation of the 1936 Regulations, then took the position, which they have urged in this case, that Article 19 (9) 1936 Edition is to be applied retroactively, so as to repeal the rule of law, Article 2 (5) 1933 Edition, which existed during the period for which the instant tax is imposed. It is submitted, however, that Article 2 (5) had the approval of Congress by the re-enactment, without change, of Section 506 of the Revenue Act of 1932 in the Revenue Acts of 1934 and 1935. Article 2 (5) of the 1933 regulations therefore had the force and effect of law, and the petitioner's tax liability for the year 1934 must be determined in conformity to the Regulations then in force, provided, of

course, that those Regulations are a reasonable and consistent interpretation of Section 506. *Helvering* v. *R. J. Reynolds Co.,* supra.

In dealing with this precise question the Court of Appeals for the Third Circuit, in a case on all fours with the instant one stated in *Commissioner* v. *Haines,* supra, at page 855:

> "In re-enacting section 506 of the Act in 1934 and 1935, Congress must be taken to have approved the Administrative construction thereof and to have given Article 2 (5) 'the force of law'. *Helvering* v. *R. J. Reynolds Company,* 59 S. Ct. 423, 426, 83 L. Ed., decided January 30, 1939. It was argued in that case that a subsequent amendment of the regulations must be applied retroactively, but the court refused to accept this argument and held that: 'Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed.' The court further said: 'We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.'
>
> "This rule of law declared in that case is dispositive of the question here involved and the tax must be assessed on the cash surrender value of the policies at the time the gift was made in accordance with the regulations then in force."

To the same effect see *Helvering* v. *Cronin; U. S.* v. *Ryerson,* supra.

POINT II.

Article 2 (5) of Regulations 79 (1933 Ed.) prescribes the rule for valuing gifts of life insurance contracts.

The Government argued in the court below that the sole purpose of Article 2 (5) (1933 Ed.) is to give examples of what are taxable gifts and that the Treasury Department did not intend it to serve as a rule for valuing gifts. The Government argues that the valuation of gifts of property is specifically provided for by Article 19, which is entitled "Valuation of Property", and that Article 2 (5) should accordingly be disregarded.

Article 19 first lays down the rule for valuing property in general and then prescribes specific rules for the valuation of real estate, stocks and bonds, interests in business, notes, intangibles, annuities and tenancies by the entirety. No specific provision is set forth therein for valuing life insurance policies for the reason that it had already been covered in Article 2 (5), which states that "the irrevocable assignment of a life insurance policy constitutes a gift *in the amount of* the net cash surrender value, if any, plus the prepaid insurance adjusted to the date of the gift." (Italics supplied.) The phrase "in the amount of" is also present in subdivisions (6) and (7) of Article 2.

When the Treasury Department amended the Regulations in 1936, it omitted from Article 2 (5) the phrase—"in the amount of the net cash surrender value, if any, plus the prepaid insurance adjusted to the date of the gift", and added at the end of the Article the statement—"For the valuation of policies of life insurance, see subdivision (9) of Article 19". If Article 2 (5) as originally promulgated in 1933, was not intended by the Treasury Department to deal with the valuation of insurance policies, then, it may be asked, why the necessity for inserting the above clause directing one now to go to another section of the Regulations for the rules for valuation of life insurance contracts, and

why was the language dealing with such valuation omitted in Article 2 (5) as amended?

That the Treasury Department clearly intended Article 2 (5) of the 1933 Regulations to prescribe the rule for valuing life insurance policies is evidenced by its own published ruling, G. C. M. 13147, supra. This ruling specifically explains how Article 2 (5) (1933 Ed.) is to be applied in determining the valuation of gifts of life insurance policies and gives detailed examples of valuation thereunder.

The language of Article 2(5) is clear and is admirably chosen to cover the gift of every form of life insurance policy regardless of when made.

With reference to the time when the gift is made, it should be noted that the article refers not only to the irrevocable assignment but also to the naming of the beneficiary of a policy. The beneficiary of a policy is always named when the policy is taken out, so that it is clear that the article is intended to cover the gift of a policy at that time. It is also to be noted that the article uses the words "if any" with reference to cash surrender value, indicating an intention to cover the gift of a policy at the time it is taken out, since in the case of an annual premium policy the reserve during the first year is not sufficient to provide a cash surrender value.

The language of the article "a life insurance policy" indicates an intention to lay down a rule which would cover the valuation of every form of life insurance policy. In the case of an annual premium policy, in which part of each premium goes to build up the reserve (or cash surrender value) and part to protection during the year, the value at any time is represented by the cash surrender value, if any, plus the prepaid insurance adjusted to the date of gift. In the case of a single premium policy, in which a reserve for the full amount of the policy is set up in advance, the reserve covers the prepaid insurance and represents the entire value of the policy.

In *U. S.* v. *Ryerson, supra,* the Circuit Court of Appeals for the 7th Circuit, in answer to the Government's contention on this point, stated at page 153:

> "We think it is apparent that the requirement of 'prepaid insurance' applies to policies upon which current premiums are still being paid. In the case of a fully paid insurance policy the cash surrender value reflects the increased value of the policy due to the fact that the insurance is fully paid up."

In G. C. M. 13147, *supra,* the General Counsel states that "It is to 'the net cash surrender value, if any,' that the addition of 'the prepaid insurance adjusted to the date of the gift' (article 2, Regulations 79) is to be made." The cash surrender value is therefore the starting point or basis for valuing life insurance policies, and only in the case of annual premium policies is that part of the premium payment, which is made before the gift and which represents the prepaid insurance, to be added to the cash surrender value. In the case of a single premium policy, the basis for aluation is its cash surrender value, which reflects the "prepaid insurance", or increased value of the policy due to the fact that the insurance is fully paid up.

Every life insurance policy is a contract on the part of the insurer to pay a fixed amount at a future date, the death of the insured. This date, while uncertain with respect to a single person, is by actuarial principles certain with respect to a large number of persons and represents the date of the expected death of each person insured. The purpose of the reserve on every insurance policy is to create a fund which at the rate of interest expected to be earned by the insurer will equal the face of the policy upon the expected death of the insured. In the case of an annual premium policy this reserve is accumulated by additions thereto from year to year, a part of each annual premium being applied to the reserve and a part to insurance or protection. In the case of a single premium policy the entire reserve is set up in the beginning in

an amount which at the rate of interest the company expects to realize upon its investments (3% to 3½% in the present instance) will equal the face of the policy at the expected date of death. The reserve on a single premium policy at all times represents the then "present value" of the face of the policy. The cash surrender value is the amount of the reserve less a small service charge for the expense of the company in connection with the surrender of the policy. For the purpose of this discussion, the terms "reserve" and "cash surrender value" are used interchangeably.

The cost of a single premium policy, however, is greater than the amount of the reserve by reason of the so-called load. Every insurance policy, in addition to the bare cost of insurance, carries a so-called load intended to cover the expense to the company in obtaining the insurance and the other expenses of operation applicable to such policy. In the case of annual premium insurance policies, these expenses are spread over the expected life of the policy and the load is included in each annual premium. In the case of a single premium policy the entire load has to be charged at the inception of the contract and is deducted from the amount of the premium in setting up the initial reserve. The expenses constituting the load on a single premium policy are charged by the company as soon as the policy is taken out and are not refundable to the insured or to any assignee of the policy. They do not enter into the reserve of the policy, which we have seen is its present value based upon actuarial computations, nor do they represent any value to the holder of the policy. They are therefore not to be taken into account in determining the fair market value of the policy.

With the exception of the Circuit Court below every Court and every Board of Tax Appeals decision on this question have uniformly held that cash surrender value alone was prescribed by Article 2 (5) as the value of a single premium policy. *Commissioner* v. *Haines; Helvering* v.

Cronin; Helvering v. *Bryan; U. S.* v. *Ryerson, supra,* and the following Memorandum Board of Tax Appeals decisions: *Charles Lockhart; Henry W. Corning; Elizabeth S. Kirk; Flora D. Supplee; Louis Florsheim; Edith W. Corning, Bettie F. Kesner, Samuel F. Houston; Firmin V. Desloge* and *Estate of Waller C. Hardy, supra.* The District Court for the Northern District of Illinois, in the case of *Ryerson* v. *U. S., supra,* held to the contrary but that decision was reversed on appeal to the Circuit Court of Appeals for the Seventh District. In *Powers* v. *Commissioner, supra,* which is the only other court decision in the Government's favor, the Circuit Court of Appeals for the First Circuit refused to apply Article 2 (5) on the theory that "it is not consistent with the language of the Act."

It is submitted that Article 2 (5) of Regulations 79 (1933 Ed.) prescribes the rule for valuing a gift of a life insurance policy and that in the case of a single premium life insurance policy, its value for gift tax purposes is its cash surrender value.

POINT III.

Article 2 (5) of Regulations 79 (1933 Ed.) is a reasonable and consistent interpretation of Section 506 of the Revenue Act of 1932.

The Circuit Court below held that "The gift tax * * * is measured by the value of the property given by him (the donor), not by the value of the property in the hands of the donee" (R. 196). It is submitted that this ruling is inconsistent with the gift tax act as interpreted by the Treasury Department in Regulations 79.

The Treasury Department has construed the word "value" as "fair market value," and defined "fair market value" as "the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell." It is evident,

therefore, that the basic theory of valuation adopted by the Treasury Department is what the property would sell for in the open market, and not a peculiar value that the property may have to the owner.

In dealing with life insurance policies, the Commissioner promulgated a rule in the 1933 edition of Regulations 79, Article 2 (5) which conformed to his theory of value as set forth in Article 19 (1). The 1936 rule, which the Circuit Court below adopted, is an unreasonable and inconsistent interpretation. Furthermore, the Treasury Department should not be permitted to adopt "fair market value" with respect to property in general, and a different value, cost to the owner, with respect to life insurance. The nature and express language of the statute requires that the word "value" have the same meaning for every type of property.

The particular policies of life insurance in question are to be valued—Article 19 (1). Under the Treasury Department's Regulations, what is the value at which these policies will change hands between a willing buyer and a willing seller?

In the Circuit Court's opinion, it is stated that:

> "When the property given is a life insurance policy, the value is the amount that it would cost to duplicate the policy at the time of the gift. That is the value commonly recognized by the courts in actions for conversion of a policy, in actions for breach of contract to issue a paid-up policy, and in allowing claims against insolvent life insurance companies" (R. 195).

The inquiry in all of these cases was not directed to what the policies in question would change hands between a willing buyer and a willing seller, but to what was necessary to indemnify the plaintiff so that he would be in the same position as before the conversion or breach of contract occurred. Quite different is the situation where a policyholder voluntarily parts with his policy; in such a case he expects to, and does receive only its fair market value, its cash surrender value.

In *Speer* v. *Phoenix Mutual Life. Insurance Company*, 36 Hun 322, 325, which involved an action to recover damages for breach of contract by the insurance company refusing to receive the premiums on a policy and continue it in force, it is stated;

> "When the company broke this contract and the plaintiff decided to sue for damages instead of compelling the continuance of its contract, he was entitled to recover a sum that equalled the value *to him* of the policy; or, in other words, that would make good *to him* the loss *he* sustained by its breach." (Italics supplied.)

The fundamental distinctions manifested by these decisions go to the very heart of the problem of valuation of insurance policies for gift tax purposes, yet the Circuit Court appears to have ignored them completely in deciding this case. The measures of value used in those cases may well be the most accurate measures where the question is one of indemnifying a particular plaintiff, but it is a very different thing to say that these are the most accurate—or even a reasonably accurate—measure of value where, as a matter of statutory construction, the value to be determined is what would be actually obtained for the *issued* policies in a willing buyer—willing seller market.

The market for insurance contracts is usually the companies who issued the policies or banks who will lend money on them. It cannot be suggested that banks will lend more than the cash surrender or loan value, yet that is what the Government would have us believe. In bankruptcy proceedings, it has long been the rule that a policy of insurance which is payable to the bankrupt's estate becomes an asset in the hands of the trustee in bankruptcy only to the extent of its cash surrender value on the date of the bankruptcy. Congress itself has approved cash surrender value as the best measure of value for purposes of the Bankruptcy Act. United States Code, Title 11, Section 110 a (5). The Interstate Commerce Commission has adopted cash sur-

render value as the soundest measure of value for purposes of the Uniform System of Accounts for carriers subject to the Motor Carrier Act, 1935, promulgated November 29, 1937 and effective January 1, 1938.

It is common knowledge that thousands of life insurance policies are surrendered to the companies each year, and the holders receive the cash surrender values. If these policies had an actual realizable value, or even some intrinsic value in excess of their cash surrender value, it is obvious that there would arise a business of purchasing such policies from people who would otherwise surrender them. Again, if the gift tax value, as contended by the Government, is the cost to duplicate the policy, then it would be logical to tax as gifts the difference between cost and cash surrender value on all policies which are surrendered.

Lucas v. *Alexander*, 279 U. S. 573, has been cited by the Government in support of its cost theory. In that case this Court had to determine the amount of capital gain for income tax purposes which was realized by a taxpayer who received at maturity the face amount of the policy, plus accumulated dividends. The policies involved had been taken out prior to 1913 and were of the so-called tontine type, on which benefits greatly in excess of the amount of the policy accrued to the holder if the policy was held until the end of the tontine period. There is no tontine feature in the instant policies.

This Court held that the value on March 1, 1913 was the policy reserve on that date, plus the proportion of the accumulated tontine dividends allocable to the policy on that date. The "value" to be determined was (p. 579):

> "that part of the amount actually realized by the taxpayer which, by the use of appropriate accounting methods, can fairly be said to have accrued before March 1, 1913—its value then as compared with the value in fact later realized by the taxpayer taken as a standard."

On that basis it was not necessary for the Court to speculate. Due to the tontine feature of this policy it was necessary for this Court to begin with the fact of the amount actually received by the insured and work backwards.

The cash surrender values of the instant policies are their reserve values, less a small surrender charge, and the reserve value in all cases was computed on the American Experience Table of Mortality with interest at 3% or 3½% (R. 29, 47, 63, 79, 97, 115, 135, 149, 163). The reserve is the face amount of the policy discounted at 3% or 3½% on the basis of the petitioner's expected life. Since the cash surrender value and the reserve in these policies were practically the same, *Lucas* v. *Alexander, supra,* is, in effect, authority for the petitioner's contention. The small surrender charge, which is the difference between the reserve and the cash surrender value, represents no value to the holder of the policy and is not to be taken into account in determining the value for gift tax purposes.

The argument has been made that some life insurance contracts do not provide for cash surrender values until the end of the first year, and that if cash surrender value is supposed to be the correct value, then such policies can have no value during the first year. The First Circuit Court of Appeals took this position in the case of *Comm.* v. *Powers, supra,* but any such argument overlooks the fact that the valuation of such a contract is a commonplace problem, involving the factor of discount and the resulting commuted values. *Simpson* v. *U. S.,* 252 U. S. 547; *Ithaca Trust Co.* v. *U. S.,* 279 U. S. 151. In the instant case the cash surrender values of the policies were furnished the petitioner by the companies who issued the policies and the correctness of these values was admitted by the Government in its answer and in the stipulation of facts (R. 17, 21). The valuations so determined are the actual values of the contracts on the date of the gift, and these valuations are based on the fact that the cash surrender values would not have been forthcoming from the insurance companies except in accordance with the terms of the contracts.

The relation of insurer and insured is solely one of contract and the contract has no existence apart from the agreement of the parties. In the case of insurance, the value at any time is not the result of the interplay of supply and demand, but of the mathematical computation of the then present value of the policy by the insurer, who, by its contract, binds itself to pay a fixed sum. A life insurance contract, therefore, can have no value greater than the insurer has bound itself to pay. There is no way that a holder of the instant policies might get more for them than through the surrender of them to the companies for their loan or cash surrender values, and the cash surrender values of the instant policies cover every element of value and include the investment feature of the policies as well as the protection features.

The Government has argued in these cases that cash surrender value is a compulsory liquidation price, and that the surrender of a policy is, in effect, a forced sale of property. It is true that situations may arise where policy owners are forced to convert their policies into cash, but it is also true that owners of Government bonds, stocks, and real estate, are forced to sell the same to obtain cash, and often at times when the market is low. It does not follow, that the price which the policy holder or the security owner receives is a "forced sale price" and less than the fair market value.

One of the principal selling points of any insurance company is that the company will pay a cash surrender value, and very few people would buy insurance policies if it meant that they could never exchange the policy for a cash sum that corresponded to the then value of what they had invested in the policy. The success of the insurance business is in itself a manifestation of the willingness on the part of the buyer that the exchange prices in the policies are a fair and accurate measure of what the policy is worth at the times stated. In this connection the District Court stated:

> "Judicial notice may well be taken that cash surrender values as determined by insurance companies

are based upon strict actuarial computations; and there is no suggestion that in the open market a buyer could be found who would pay a greater sum for the policies than that which the insurance actuaries determine to be their cash surrender values. Certainly defendant's investigation into the accuracy of such calculations cannot compel a finding that the insurance companies should pay a greater cash surrender value than they stipulate to pay in the contracts of insurance". (R. 180)

In *Behrend* v. *Commissioner,* 23 B. T. A. 1037, 1041, one of the questions involved was the value of an insurance policy irrevocably assigned as a gift. In holding that the cash surrender value represents the amount of the gift as a charitable deduction for income tax purposes, the Board stated:

> "***The cash surrender value of the policies on that date is based upon years of actuarial experience, and this value is a convenient, reasonable and proper measure of the amount of the contribution or gift which the petitioner made on that date."

It is to be noted that the Commissioner acquiesced in this decision—C. B. X-1, p. 5.

The true test of value is what these contracts can be sold for, not what it will cost to buy a new policy from the insurance company which chooses to make a service charge for issuing another. If a man gives his son $1,000. to buy a car, the gift is $1,000., for that is what was given. If he gives his son a car, or an insurance policy, they are the subjects of the gift. It is the issued policy or the purchased car which must be valued and what they are worth in the open market is the test to be applied.

It is submitted that a measure of value, which is prescribed by the Commissioner in his Regulations, will come within the standard fixed by the Act if it affords a reasonably accurate measure of the monetary value of the gift. Article 2(5) of Regulations 79 (1933 Ed.) prescribes a

reasonably accurate measure of value which is consistent with the statute and Article 19(1). The fact that some other measure of value, might have been a reasonable interpretation, or the fact that the regulation embodying the first test or measure of value might later be modified and still represent a valid exercise of power by the Commissioner, does not in any way vitiate the validity and the binding force of the first regulation during the period that it was officially recognized and enforced.

CONCLUSION.

The Circuit Court below erred in holding that the Treasury Regulations in effect in 1934 did not prescribe that cash surrender value be taken as the fair market value of a gift of a single premium life insurance policy, that cash surrender value is not the fair market value of a single premium life insurance policy, and that under the Gift Tax Act the value of such a policy in 1934 is to be measured by the cost to the owner. The judgment of the Circuit Court should be reversed and the judgment of the District Court reinstated.

Respectfully submitted,

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Of Counsel:

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December 16, 1940.

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APPENDIX.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 501. IMPOSITION OF TAX.

(a) For the calendar year 1932, and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift. * * * (U. S. C., Title 26, Sec. 1000.)

SEC. 506. GIFTS MADE IN PROPERTY.

If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift. (U. S. C., Title 26, Sec. 1005.)

SEC. 530. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title (U. S. C., Title 26, Sec. 1029).

Treasury Regulations 79, pertaining to the Revenue Act of 1932, promulgated October 30, 1933:

ART. 2. *Transfers reached.*—The statute imposes a tax whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. * * * In the following examples of transactions resulting in taxable gifts, it will be understood that the transactions occurred after the date of the enactment of the statute (June 6, 1932), and were not for an adequate and full consideration in money or money's worth:

* * *

(5) The irrevocable assignment of a life insurance policy, or the naming of the beneficiary of a

policy without retaining any of the legal incidents of ownership therein, constitutes a gift in the amount of the net cash surrender value, if any, plus the prepaid insurance adjusted to the date of the gift.

(6) Where premiums on a life insurance policy are paid by an insured who has none of the legal incidents of ownership in the policy, and the beneficiary is other than the insured's estate, each premium payment is a gift in the amount thereof.

* * *

ART. 19. *Valuation of property*—(1) *General*—The statute provides that if the gift is made in property, the value thereof at the rate of the gift shall be considered the amount of the gift. The value of property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell. Where the property is sold within a reasonable period after the date of the gift, and it is shown that the selling price reflects the fair market value thereof as of the date of the gift, the selling price will be accepted as the amount of the gift. All relevant facts and elements of value as of the time of the gifts should be considered in every case.

* * *

Subdivisions (2) to (8), inclusive, of this article deal, respectively, with the valuation of real estate, stocks and bonds, interest in business; notes, secured and unsecured; intangibles; annuities, life, remainder, and reversionary interests; and tenancies by the entirety.

Treasury Regulations 79, relating to the Revenue Act of 1932, promulgated February 26, 1936:

ART. 2. *Transfers reached.*—The statute imposes a tax whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intan-

gible. * * * In the following examples of transactions resulting in taxable gifts, it will be understood that the transactions occurred after the date of the enactment of the statute (June 6, 1932), and were not for an adequate and full consideration in money or money's worth:

* * *

(5) If the insured assigns a life insurance policy, or designates a beneficiary in such a policy, but does not retain what amounts to a power of revocation (as, for example, the right to surrender or cancel the policy, the right to obtain a loan against the policy or its surrender value, or a right to change the beneficiary or assignee, if by the exercise of such latter right the proceeds of the policy might be made payable to the insured, his estate, or otherwise for his benefit), such assignment or designation constitutes a gift, even though the right of the assignee or beneficiary to receive the proceeds is conditioned upon his surviving the insured. For the valuation of policies of life insurance, see subdivision (9) of article 19.

* * *

ART. 19. *Valuation of property.*—(1) *General.*—The statute provides that if the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift. The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell. The value of a particular kind of property is not to be determined by a forced sale price. Such value is to be determined by ascertaining as a basis the fair market value at the time of the gift of each unit of the property. For example, in the case of shares of stock or bonds, such unit of property is a

share or a bond. All relevant facts and elements of value as of the time of the gift should be considered.

* * *

(9) *Life insurance and annuity contracts.*—The value of a life insurance contract or of a contract for the payment of an annuity issued by a company regularly engaged in the selling of contracts of that character is established through the sale of the particular contract by the company, or through the sale by the company of comparable contracts. As valuation through sale of comparable contracts is not readily ascertainable when the gift is of a contract which has been in force for some time and on which further premium payments are to be made, the value may be approximated, unless because of the unusual nature of the contract such approximation is not reasonably close to the full value, by adding to the interpolated terminal reserve at the date of the gift the proportionate part of the gross premium last paid before the date of the gift which covers the period extending beyond that date.

The examples given below, so far as relating to life insurance contracts, are of gifts of such contracts on which there are no accrued dividends or outstanding indebtedness.

Example: A donor purchases from a life insurance company for the benefit of another a life insurance contract or a contract for the payment of an annuity; the value of the gift is the cost of the contract.

* * *

Example: A donor owning a life insurance policy on which no further payments are to be made to the company (e. g., a single premium policy or paid-up policy) makes a gift of the contract. The value of the gift is the amount which the company would charge for a single premium contract of the same specified

amount on the life of a person of the age of the insured.

G. C. M. 13147. A ruling is requested as to the proper method of computing the value of a life insurance policy, for gift tax purposes, which was irrevocably assigned on April 1, 1933, without consideration.

Section 501 of the Revenue Act of 1932 imposes a tax upon all transfers of property by any individual after June 6, 1932, to the extent that they are donative in character and exceed the authorized deductions.

SEC. 506 OF THAT ACT PROVIDES THAT——

"If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift."

Article 2 of Regulations 79 reads in part as follows:

"The statute imposes a tax whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. * * *

(5) The irrevocable assignment of a life insurance policy, or the naming of the beneficiary of a policy without retaining any of the legal incidents of ownership therein, constitutes a gift in the amount of the net cash surrender value, if any, plus the prepaid insurance adjusted to the date of the gift."

A life insurance policy in the amount of $100,000 taken out on January 1, 1928, was irrevocably assigned by the insured on April 1, 1933, without consideration. The annual premium of $2,849 was payable in advance on January 1. The policy provides in part as follows:

"The cash surrender value shall be the reserve on the face of the policy at the end of the insurance

year or, in event of default, at the date of defaul (omitting fractions of a dollar per thousand of insur ance) and the reserve on any outstanding paid-u additions, under section 2, option (c), plus any divi dends standing to the credit of the policy, under sec tion 2, option (d), and less a surrender charge fo the third to the ninth years, inclusive, of not mor than 1½ per cent of the face of the policy. Such re serve will be computed on the basis of the America Table of Mortality and interest at 3 per cent, and th amount of paid-up insurance under (2) and the term of the continued insurance and amount of pure en dowment under (3) will be computed on the same basis at the attained age of the insured on the dat of default.

"The values in the table opposite are compute in accordance with the above provisions, assumin that premiums have been paid in full when due fo the number of years stated, that there is no indebted ness to the company, no outstanding paid-up addi tions, no dividends standing to the credit of the polic and that no dividends have been applied on the ac celerative endowment plan; the surrender charge, i any, has been deducted."

After the policy has been in force for a period o four years the cash surrender value for each $1,00 of the face amount is $46, and after the policy ha been in force for a period of five years the cash sur render value for each $1,000 of the face amount i $63. All premiums were paid when due, no indebted ness was due the company by the holder prior t assignment, and there were no paid-up additions an no dividends standing to the credit of the policy.

It is to "the net cash surrender value, if any," that the addition of "the prepaid insurance adjuste to the date of the gift" (article 2, Regulations 79

is to be made. The word "prepaid," meaning in advance or beforehand, obviously refers to a payment antedating the making of the gift. Fundamentally, life insurance, like other insurance, is simply a contract. By paying premiums the insured obtains the promise of the insurer to pay money on the former's death, or before that event. As such promise by the insurer is "insurance," and is bought by the premium payments, the two words, "prepaid insurance," manifestly mean a *premium payment* made before the gift to obtain the promise of the insurer. That promise may be to pay a sum in cash on surrender of the policy contract, or if not surrendered, to pay the face of the policy on the insured's death. Whatever the terms of the promise, the obtaining or purchasing thereof is through *premium payments*.

The following examples illustrate the Bureau's interpretation of the meaning of the concluding clause of subdivision (5) of article 2, Regulations 79, reading—"plus the prepaid insurance adjusted to the date of the gift";

1. In a case where the cash surrender value of the policy at the end of the insurance year 1932 was $4,600, and where such value was increased to $6,300 immediately upon the payment on January 1, 1933, of the $2,849 premium due for the insurance year 1933, the amount of the gift on April 1, 1933, the date on which the policy was irrevocably assigned was $6,300, representing the cash surrender value of the policy, plus $861.75, representing the prepaid insurance adjusted to the date of the gift. (Premium paid January 1, 1933, $2,849 less $1,700, the additional cash surrender value created by the payment of such premium, and less $287.25, representing the earned premium from January 1 to April 1, 1933; $2,849—$1,700 = $1,149 — $287.25 = $861.75.)

2. In a case where the premium was duly paid for the insurance year 1933, where the cash surrender value of the policy at the end of the insurance year 1932 was $4,600, where the cash surrender value was increased to $6,300 at the end of the insurance year 1933, and where the cash surrender value of $6,300 was adjustable to the date of surrender of the policy, the amount of the gift on April 1, 1933, the date on which the policy was irrevocably assigned, was $5,025 (representing the cash surrender value adjusted to April 1, 1933), plus the present worth of $1,275 (the balance added to the cash surrender value at the end of the insurance year 1933), plus $861.75, representing the unearned premium adjusted to the date of the gift and computed in the manner set forth in example 1.

3. In a case where the $2,849 premium was duly paid for the insurance year 1933, where the cash surrender value of the policy at the end of the insurance year 1932 was $4,600, where that value was increased to $6,300 at the end of the insurance year 1933, and where the cash surrender value of $6,300 was not adjustable to the date of surrender of the policy, the value of the gift on April 1, 1933, the date on which the policy was irrevocably assigned, was $4,600 (representing the cash surrender value of the policy), plus the present worth of $1,700, the amount added to the cash surrender value at the end of the insurance year 1933, plus $861.75, representing the unearned premium adjusted to the date of the gift and computed in the manner set forth in example 1.

In view of the foregoing, it is held that, where the insured makes a gift of the insurance to another, the insured having theretofore paid a premium in purchase of the insurer's promise, which promise covers a period not yet elapsed when the gift is made, the value of the gift includes (as illustrated in the fore-

going examples) the net cash surrender value of the policy at the date of the gift and that proportionate part of the premium paid before the gift, which covers a period extending beyond the gift. When the premium payment purchases the right to an increased cash surrender value, which is not available until the end of the policy year, a discount is required in arriving at its present worth as of the date of the gift. [G.C.M. 13147, C.B. June 1934, p. 358.]